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SUBJECT: SRI LANKA'S TEA SECTOR: "A GIFT FROM GOD"

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¶1. (U) SUMMARY: Long Sri Lanka's top export, tea remains one of the country's most valuable foreign currency earners despite being supplanted by the textile sector in the top slot. The country's highly sought-after "orthodox" teas remain global favorites, particularly in the Middle East and the countries of the former Soviet Union. Despite years of civil strife, alternating nationalization and semi-privatization schemes, and commodity price fluctuations, the Sri Lankan tea industry remains competitive and the country today ranks as the fourth-largest tea producer in the world. Sri Lanka's tea growers remain confident that thmet with Mr. Vish Govindasamy, Managing Director, and Mr. Dushy Ratnasingham, Chief Operating Officer, of Watawala Plantations -- one of the largest tea producing companies in Sri Lanka with nearly 30,000 acres of tea -- on November 18. Govindasamy noted that Sri Lanka is known as the best place to grow orthodox tea (vice CTC, or "cut, tear, curl" teas produced more cheaply elsewhere). With "orthodox" tea production, the withered leaf is rolled, thereby breaking the leaf's veins and releasing the enzymes. Govindasamy emphasized that Sri Lanka's climate and soil in the growing regions are "a gift from God" -- "perfect for growing rich, aromatic teas." Sri Lanka's export-oriented tea production is highly conscious of protecting the quality of its tea, and the industry maintains self-imposed standards which must be met to receive the "Lion Logo" for Sri Lankan tea. Still, over 55 percent of Sri Lankan tea exports are sold in bulk. Many business leaders think Sri Lanka should move to upgrade their tea exports to branded teas to increase their earnings.

¶3. (U) According to the Food and Agriculture Organization, Sri Lankan tea is categorized as the "cleanest tea" in the world, a direct result of the restrictions on fertilizer and pesticide usage which limits chemical residue on the leaves. Further, the country's tea tasters insist that the CTC tea produced in Kenya, India, and Indonesia simply cannot match the taste, aroma, and quality of Sri Lanka's orthodox teas. Only Vietnam has been able to produce orthodox tea of the same leaf standard as Sri Lanka, however, as Govindasamy emphasized, they "cannot match our taste." Indeed, Sri Lanka historically get some of the highest prices for teas in the world.

¶4. (U) Sri Lanka is currently the fourth-largest tea producer in the world after China, India, and Kenya. It's annual tea production in 2008 amounted to approximately 318,000 metric tons, which accounts for roughly ten percent of the global tea crop. However, Sri Lanka exports the majority of its tea, roughly 300,000 metric tons last year, making it the world's second largest tea exporter (about 18 percent of the

global tea market). Sri Lanka exports most of its tea to former Soviet republics, the Gulf states, other Middle Eastern countries, and as a blend to Europe and the United States. In 2008, Sri Lanka's tea industry earned over \$1.2 billion, or approximately 16 percent of export earnings.

GROWERS HIT BY RECESSION BUT REMAIN STRONG

15. (U) The small tea growers, with plots smaller than 50. Still, growers large and small have suffered in 2008-2009 as global commodity prices crashed. In addition, a drought in early 2009 also resulted in a significant drop in production, with cumulative production for January-October 2009 amounting to only 234,000 metric tons -- the lowest level since 1999. Due to a world wide crop shortage, tea prices at Colombo tea

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auctions recovered recently -- hitting an all-time high of over \$3.70/kilo in September (versus \$2.22/kilo in October 2008 and \$2.93/kilo in 2007). A kilo of tea is currently fetching around \$4.45.

16. (SBU) Sri Lanka's large tea plantations -- those once owned by English and Scottish operators -- are run by regional plantation companies (RPCs) and contribute about 40 percent of tea production. The government nationalized these large tea plantations in the early 1970s and tried to manage them (without success). In 1996, the GSL privatized the management of the plantations by signing five-year management agreements. Now-a-days, the privately-owned RPCs manage the plantations under 53-year lease agreements. The land remains under government ownership, however. This may limit the amount of money the RPCs (themselves listed on the Colombo Stock Exchange) are willing to invest in infrastructure and production improvements, especially as the end of the lease draws near.

LABOR INCENTIVES AND GOVERNMENT ASSISTANCE EXPECTED TO HELP

17. (SBU) Labor relations in the tea sector can be thorny as union leaders are often members of Parliament and Cabinet, creating a highly politicized environment. Plantation workers are descendants of Indian Tamils brought to Sri Lanka by the British in the late 1800s. The workers have jobs for life on the large plantations, but Ratnasingham lamented that wages and productivity were traditionally not linked. (NOTE: Small plantations are not covered by the same labor regulations. END NOTE.) To rectify this, a productivity component was included for the first time in the October 2009 collective bargaining agreement with plantation workers. Wages were increased to SLR 405/day up from SLR 290/day, and includes a SLR 285 basic wage, SLR 30 productivity incentive, and SLR 90 attendance incentive. If these incentives result in higher productivity, the wage increase should not negatively affect the bottom line. However, insiders indicate profitability could be hit should production or prices drop. On top of their wage, companies also provide workers with health, maternity and child care benefits, along with basic housing. Unfortunately, alcoholism-caused truancy remains a serious social and economic problem on the plantations, and poverty rates among tea plantation workers are the highest in the country.

18. (SBU) The conflict in the North and East with the Tamil Tigers had little effect on the tea plantations. (NOTE: The plantation Tamils arrived centuries later than the Tamils in the North, are considered a separate ethnic group, and were not Tamil Tiger members. END NOTE.) The conflict negatively affected resources for ancillary institutes like the Tea Board (which used to successfully market Sri Lankan tea but is today nearly defunct), and the Tea Research Institute (which used to provide top R&D to the industry but is today underfunded). Still, despite the government's need to fund the war, it did not raise export duties and collects just SLR 4/kg cess on exports, and tea machinery -- a high-value imported input -- also remains duty-free. In fact, Sri Lanka has the highest amount of tea bagging machinery in one country. With the war over, and the possible EU withdrawal of GSP Plus (reftel), tea insiders expect the GSL to focus increased resources on the tea industry to ensure Sri Lanka's tea exporters maintain their envious market position.

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